

## **EMPLOYEE MISCLASSIFICATION TASK FORCE**

### **LEGAL COMMITTEE – 2012 FINAL REPORT**

**Committee Members:** Dan Bailey, Chair (TN DOL Attorney); Abbie Hudgens (Administrator – Workers’ Compensation Division, TN DOL); Ashley Arnold (General Counsel – Insurors of TN); Bob Pitts (Association of Building Contractors); Adrienne Fazio (Attorney – Workers’ Compensation Division, TN DOL); Kevin Hale (Hale Insurance); Matt Capece (United Brotherhood of Carpenters and Joiners of America). One of the committee meetings this year was a joint meeting with the Education Committee. There was also participation in the Legal Committee meetings by Workers’ Compensation Division investigators John Basford and Norm Auffhammer.

The Legal Committee submits the following recommendations for the Employee Misclassification Taskforce’s consideration. Following the recommendations are the committee’s responses to statutory questions that were posed by the General Assembly and other events/meetings that occurring during 2012 that helped to generate these recommendations. The recommendations are listed in no particular order.

#### **Committee Recommendations:**

1. Seek legislation granting the Workers’ Compensation Division the authority to issue a civil monetary penalty to an employer found to have committed workers’ compensation insurance premium avoidance;
2. Seek legislation granting the Workers’ Compensation Division the authority to issue and enforce (civil monetary penalty) stop work orders against any contractor found to not be in compliance with Tennessee Workers’ Compensation Laws;
3. Include the State Building Commission, Tennessee Department of Transportation (TDOT), and General Services on the Task Force to assist with enforcement on State funded construction projects. Also, include the Tennessee Department of Financial Institutions on the Task Force to assist investigations involving check cashing services;
4. Provide funding to obtain fraud detection software and analytical support for the Workers’ Compensation Division to assist investigators in identifying likely violators based on certain indicators;
5. The Tennessee Department of Labor should enter into a memorandum of understanding (MOU) with the U. S. Department of Labor (DOL) to foster joint investigative and enforcement action with federal DOL;

6. The Workers' Compensation Division should develop contacts and working relationships with officials, including law enforcement officials, of surrounding States who investigate and enforce their laws against employee misclassification;

The Legal Committee submits the following responses to the statutory questions it was assigned to address this year:

***T. C. A. §50-6-919(b)***

**(9) Whether improvements are needed to facilitate the filing of complaints and identify potential violators, including, but not limited to, soliciting referrals and other relevant information from the public.**

**RESPONSE:** The Legal Committee submits three recommendations for facilitating the filing of complaints and for the improvement in identifying potential violators. The main recommendation for facilitating the filing of complaints is effective enforcement. Once compliant construction contractors witness effective enforcement by the Department of Labor & Workforce Development ("Department") they will have more confidence in knowing that if they report a contractor who is misclassifying its workers that something will actually be done about it and that knowledge will generate complaints from those compliant contractors. The Department's current legal authority to penalize non-compliant contractors is limited to contractors found to be not carrying workers' compensation insurance and not paying their unemployment insurance premiums because they have misclassified their workers as independent contractors or they have worked their employees "off the books". The Department currently has no statutory authority to issue stop work orders to non-compliant contractors, nor does it have the authority to assess monetary penalties against contractors who commit workers' compensation insurance premium fraud. Until the Department is granted enhanced statutory authority to penalize and/or stop the work of non-compliant contractors, it is doubtful that the many compliant contractors will bother to file a complaint.

The second recommendation is utilization of effective technology to identify potential non-compliant contractors. There are software applications currently available that can cross-reference several different state and associational databases to permit an investigator to hone in on employers who are likely engaging in employee misclassification. This will help the Department's investigators to work more efficiently and to cover more territory.

On July 16, 2012, a meeting was held at the Department of Labor in which three fraud detection vendors presented their product to a dozen attendees representing each of the Task Force committees. The vendors who presented were Thomson Reuters' CLEAR, Risk Metrics Corporation, and Insurance TechKNOWLEDGEy. The cost for a fraud detection system will depend on which vendor, if any, is chosen. One vendor, Insurance TechKNOWLEDGEy, has offered to provide its service to the Department of Labor and the State Contractor Licensing Board free of charge. The cost for such a system, if any, will have to be weighed against the improved efficiency and greater coverage capabilities that it will provide our investigators.

The third recommendation is a public outreach and awareness campaign. The goal of such a campaign would be to educate the workers who may be employed or may be come

employed by a non-compliant employer. Suggestions for getting information to these workers are:

- a) placing informational pamphlets in the Tennessee Career Centers and at job fairs in both English and Spanish;
- b) media ad campaigns in English and Spanish;<sup>1</sup>
- c) public service announcements in English and Spanish; and
- d) providing educational information regarding these practices via social media and in routine mailers already sent to employers from the Department.

**(10) Changes in the law, if any, that need to be made in order to ensure that agencies represented by task force members investigating the failure of employers to properly classify individuals as employees under their own statutory or administrative enforcement mechanism have the authority to refer a matter to other participating agencies for assessment of potential liability under the other agencies' relevant statutory or administrative enforcement mechanisms.**

**RESPONSE:** No changes in the law are necessary. Nothing currently in the law prohibits agencies represented by task force members from referring a matter to other participating agencies for potential liability under the other agencies' statutory or administrative enforcement mechanism.

**(13) Any other issues relative to employee misclassification in the construction industry.**

**RESPONSE:** The Legal Committee recommends that the Department and other task force member agencies contact the governmental agencies and attorney general offices in contiguous states to establish a referral process with them. This is needed due to the number of non-compliant companies working in Tennessee from other states. If they are breaking the law in Tennessee they are likely doing the same in their home state. In such cases, enforcement actions in home states along with Tennessee will create greater accountability.

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<sup>1</sup> Cost will be a factor on how much, if any, of this will be doable.

The Legal Committee submits the following information, suggestions and/or recommendations:

### **Florida Telephone Conference**

On August 13, 2012, a telephone conference was held here at the TDOL with three officials of the State of Florida Fraud Division. In attendance were Dan Bailey (TDOL Attorney), Blake Alford (Attorney for TN Workers' Comp Division), Adrienne Fazio (Attorney for TN Workers' Comp Division), John Basford (TN Workers' Comp Division Investigator), Carol Duncan (TN Workers' Comp Division), Sue Gordon (TN Workers' Comp Division), Jeanie Talton (TN Workers' Comp Division), Joe Jones (TN Employment Security Tax Auditor), Eric Glapa (TN Employment Security Tax Auditor), Santiago Rodriguez (TN Labor Standards Investigator), George Bell (TN Attorney General's Office), Alex Reed (TN Attorney General's office), James Milam (Davidson County District Attorney's Office), Lynn Ivanick (Workers' Comp Advisory Council & Chairperson of the Education Committee), Kevin Hale (Hale Insurance), and Bob Pitts (Association of Building Contractors). Carolyn Lazenby (TN Contractor's Licensing Board) participated by telephone. The three Florida officials were Detective Andrew Genio (Fraud Division), Major Geoffrey Branch (Fraud Division), and Deborah delaPaz-Boxer (Fraud Division).

The Florida officials told us about a scheme that they contend is rampant in the Florida construction industry. The basic way it works is that a person they call the Originator will set up a shell company or companies with no employees in the name of another person, oftentimes a fictitious person, and give the shell company a generic name that does not identify with any type of construction service. The Originator will purchase several minimum premium workers' compensation policies in the name of the shell company and then rent those policies to construction service contractors for a percentage of the profits. The construction service subcontractor will bid jobs in the name of the shell company and use the rented workers' comp policy to show proof of coverage. The General Contractor will issue a business-to-business check to the shell company for the work performed by the construction service provider who rented the policy. The Originator will have a prearranged set-up with a check cashing service provider, who are part of the conspiracy, to cash the business-to-business check for a percentage of the check amount. The check cashing service usually has never met the person who supposedly owns the shell company or who is the principal owner of the shell company. The check cashing service will have a rubber stamp made of the supposed owner's signature and thumb print. The Originator, or usually someone on his/her behalf called a Facilitator, will get the business-to-business check cashed at the co-conspiring check cashing service and then pay the workers of the subcontractor posing as the shell company in cash. The shell company will usually dissolve within a year just prior to the annual audit by the issuer of the workers' comp policy. The Originator will then set up a different shell company or companies after dissolving the first one and the illegal conspiracy continues. Florida officials stated that typically when they get to a point in an investigation involving a shell company where they can obtain a subpoena to search the check cashing service then the investigation takes off because the check cash service will tell them all about the scheme.

In part to address this scheme, Florida, through its employee misclassification task force and its sub-task force addressing check cashing services, have caused some legislation to be enacted to help with their enforcement efforts in these areas. Regarding check cashing services, it is a felony under Florida law for a checking cashing service to possess the tools of the

conspiracy such as an endorsement stamp and a thumb print stamp of the supposed shell company owner (usually a fictitious person). It is also a felony in Florida for an employer to not report to its workers' comp carrier within seven (7) days any changes to the employer's operations that would have an effect on the employer's policy. Under Florida law they have the authority to issue a stop work order on any contractor that they find to not be in compliance with the workers' compensation statute. Florida law provides for either a civil fine or criminal sanction for violating the stop work order.

Check cashing services in Tennessee is regulated by the Department of Financial Institutions (DOFI). A review of the Tennessee Check Cashing Act (T. C. A. §45-18-101 *et seq.*) reveals the licensing requirements for check cashing service providers; it shows that the Commissioner of DOFI has the authority to do periodic examinations of the check cashing service and that it is a Class E felony to knowingly and willfully make a false statement in any document that is required to be filed such as a cash transaction report. Tennessee law does not prohibit check cashing services from possessing signature or thumb print stamps.

**RECOMMENDATION** – Although we do not have empirical data to show that the shell company conspiracy described by Florida officials exists in Tennessee we strongly suspect that it does. To help in understanding how to address this scheme in Tennessee the joint committee recommends that Tennessee's Employee Misclassification Task Force be expanded to include the Tennessee Department of Financial Institutions.

#### **Items that should be addressed and/or included in the 2013 report of the Task Force**

- A. Joint investigation results;
- B. What's happening in other States;
- C. To enhance enforcement on State contracts recommend that the State Building Commission, the Tennessee Department of Transportation (TDOT), and the Department of General Services become members of the Employee Misclassification Task Force;
- D. The efforts of the Task Force in studying fraud detection software systems, the experience other States have had with such systems, and the possible recommendation of the Task Force as to which fraud detection software system should be pursued and why; and
- E. Recommendations for legislation to enhance enforcement.

#### **Recommendations for methods to level the playing field for contractors who play by the rules.**

- A. Public awareness campaign targeted towards employers and employees in the construction service industry;

- B. Departmental speaking tour – Have knowledgeable speakers from the TDOL and Commerce & Insurance available to speak at appropriate conferences, etc.;
- C. Place links on the Employee Misclassification website to educational materials;
- D. Increase effective enforcement; and
- E. Inclusion of the State Building Commission, TDOT, and General Services on the Task Force to assist with enforcement on State funded construction projects.

**Future Action Items.**

- A. Obtain fraud detection software and analytical support to assist investigators;
- B. Continue to promote coordinated investigations among Task Force agencies;
- C. Seek involvement and assistance from State Building Commission, TDOT, Department of General Services, and Department of Financial Institutions;
- D. Develop contacts and working relationships with officials, including law enforcement officials, of surrounding States who investigate and enforce their laws against employee misclassification; and
- E. Enter into a memorandum of understanding (MOU) with the federal Department of Labor (DOL) to foster joint investigative and enforcement action with federal DOL.
- F. Explore the possibility of entering into a MOU with the Internal Revenue Service to obtain information regarding employers filing form 1099 (independent contractor).